ATLANTA COUNCIL RETREAT

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Public Pension Environment

1. **State and Local Government Budget Shortfalls**
   - Federal money going away
   - Slow revenue recovery
   - Austerity measures
   - Structural change
2. **Federal Activity**
   - SEC New Jersey settlement
   - Public Employee Pension Transparency Act
   - Potential State Bankruptcy
   - Possible ERISA-like oversight
3. **Public Opinion**
   - Job/Pension/Health Benefit Envy
   - Confusion about benefit levels and cost
   - Perceptions of public workforce
   - Shifting perception on collective bargaining
4. **GASB Exposure Draft on Pension Reporting**
   - Determining liabilities
   - Recognizing benefit increases
   - Level funding method
   - Reporting vs. Funding

Defined Benefit and Defined Contribution Characteristics

- Under a DB plan, the benefit is defined and the contribution is not
- Under a DC plan, the contribution is fixed, but the benefit is not
- Plan risks:
  - Investment Risk
  - Demographic Risk
  - Post-retirement Cost-of-Living Risk
  - Longevity Risk
- In a DB plan, the employer usually bears these risks
- In a DC plan the employee usually bears these risks
- Hybrid plans share the risks

Note: This presentation focuses on retirement risk. Plan changes may open the City and/or employees to unintended consequences.

Risk and Features of Different Retirement Plans

Employer and Employee Risk of Different Designs

	Defined Benefit										Defined Contribution	
	Flat Dollar		Career Average		Final Average		Hybrid		Lump Sum Options		401(a), 401(k), 403(b)	
	ER	EE	ER	EE	ER	EE	ER	EE	ER	EE	ER	EE
Economic Risks												
Investment Risk	4	1	4	1	4	1	3	2	3	3	0	4
Inflation risk	0	4	1	3	3	2	2	2	2	2	1	3
Contribution Risk	3	1	4	1	4	1	3	1	3	1	1	1
Longevity Risk	4	0	4	0	4	0	3	2	3	4	0	4
Non-Economic Risks												
Accounting Risk	3	0	3	0	3	0	3	0	3	0	0	0
Features												
Rewards older/longer service employees	4		3		3		2		2		1	
Planning Tool	2		2		2		1		1		1	
Hiring Attractiveness	2		2		2		3		3		3	

Risks	Features
0 None	Not applicable
1 Low	Minor importance
2 Somewhat low	Somewhat minor importance
3 Somewhat high	Relatively important
4 High	Very Important

Relative Impact of Defined Benefit Plan Changes

- **Principles to consider—strike the right balance among:**
  - Budget constraints and reasonable annual funding
  - Responsible stewardship of plans
    - Reasonable actuarial assumptions and methods
  - Recognize constitutional and contractual obligations of the State or locality to its employees
  - Need for stakeholder input

- **Level of contributions needed to support existing plans in current form may not be sustainable.** A long-term solution will require focus on all four levers:
  1. Employer contributions
  2. Benefits
  3. Employee contributions
  4. Investments

Relative Impact of Defined Benefit Plan Changes

Boulders, Rocks, Pebbles, Sand

There are numerous benefit changes that would reduce cost, but by how much?

This is a way of prioritizing/ranking changes based on their impact to the ARC.

Boulders
Substantial Reduction in ARC—more than 20%

Rocks
Large Reduction in ARC—at least 10%

Pebbles
Small Reduction in ARC—about 5%

Sand
Minimal Reduction in ARC—less than 5%

Impact on ARC is estimated

Relative Impact of Defined Benefit Plan Changes

Types of potential changes—will likely require legislative approval

Boulders

- Eliminate the COLA
- Deliver future pension benefits under a new plan structure with shared risk
- Change to a career average pension plan
- Change to a cash balance pension plan

Rocks

- Modify the COLA
- Increase minimum retirement age for unreduced benefits
- Increase minimum age for early retirement benefits and/or penalties
- For current active employees in current plan, change benefit formula for future service
- Increase employee contribution rate

Relative Impact of Defined Benefit Plan Changes *continued*

Types of potential changes—will likely require legislative approval

Pebbles and Sand

- Increase final average salary period from 3 years to 5 or 7 years
- Eliminate interest on member accounts
- Reduce disability and death benefits
- Prohibit pay spiking

Trends:
Continuum of Public Retirement Plan Redesign

Defined Benefit	Combined Plans	Cash Balance	Defined Contribution
• Retention of defined benefit plan with changes for new hires: – Raise retirement eligibility – Raise contributions – Lower multiplier – Reduced or suspended COLA – Eliminate rehired retirees and spiking • Some states/localities have reduced COLA for existing retirees • Some states/localities are considering changes for future accruals for current active employees	**Washington** • Employee choice of: – Plan 2: DB–2% of pay plan – Plan 3: » DB–1% of pay plan » DC Employer contribution: 8% Employee contribution: 5% – 15% **Oregon** • Combined DB/DC plan • Tier II: – DB 1.5% of pay plan employer funded – DC 6% employee funded **Utah** (July 2011) Employee Choice of: • Tier II: – DB 1.5% of pay plan – 10% cap on employer contributions • DC funded by "excess" employer contributions OR • DC 10% employer contributions	**Nebraska** (January 1, 2003) • Employees contribution: 4.8% • Employer contribution: 7.5% • Investment return guarantee: – At least 5% annual return – Potential for additional Board approved amount – Total not to exceed 8%	**Alaska** (July 1, 2006) • All new employees • Employer contribution: 3.5% plus 3.75% to retiree health fund • Employee contribution: 8% **Michigan** (March 1997) State Employees: • Employer contribution: 4% up to 7% • Employee contribution: up to 3%

There are many choices for redesign.

Trends:
Summary of Recent State Plan Changes

		Change	Approach
Contribution Rates	Employer	CA, CO,FL, IA, LA, MN, NJ, NM	• Raise contribution rates • Lower contribution rates
	Employee	CO, IA,, LA, MN, MO, MS, VA, VT, WY	• Raise Contributions • Mandate contributions
COLA	New Hires	CO, IL, MI, MN, SD, UT, VA	• Suspension tied to funding or CPI • Tied to funding percentage • Delay start
	Actives	CO, MN, SD	
	Retirees	CO, MD, MN, SD	
Sponsor Contribution Rules		IA, NJ, VA, VT	• Additional contributions to ARC • Require ARC
Anti-Spiking		AZ, CO, IA, IL, NJ, VA	• Pensionable compensation • Longer FAS period • Longer vesting periods • Cap compensation growth in FAS period
Multiplier	New Hires	GA, NJ	• Lower multiplier • Reduce longevity multiplier
	Actives	VT	
Retirement Eligibility	New Hires	IL, MN, MO, MS	• Raise service requirements • Eliminate combined age/service rule • Increase combined age/service rule
	Actives	AZ, CO	
Retirement Age	New Hires	MO	• Raise normal retirement age • Coordinate with social security normal retirement age
	Actives	AZ, CO, VT	
Re-employment		CO, GA, IL, MI, MS, NM, SD, UT	• Eliminate service accrual after rehire • Suspend pension and health benefits based on earnings after rehire
Hybrid	New Hires	GA, MI, UT	• Combine Defined Benefit plan with a lower multiplier with Defined Contribution overlay • Choice of hybrid or Defined Contribution
Defined Contribution	New Hires	NJ, UT	• Part-time workers • Elected officials provided an employer match

Source: National Conference of State Legislatures, July 2010

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Options that save at least $15 million annually

1

Defined Benefit (DB) Plan Only approach

- Increase Employee Contributions from 8% to 14%
- All other provisions remain unchanged

2

Defined Contribution (DC) Plan Only approach

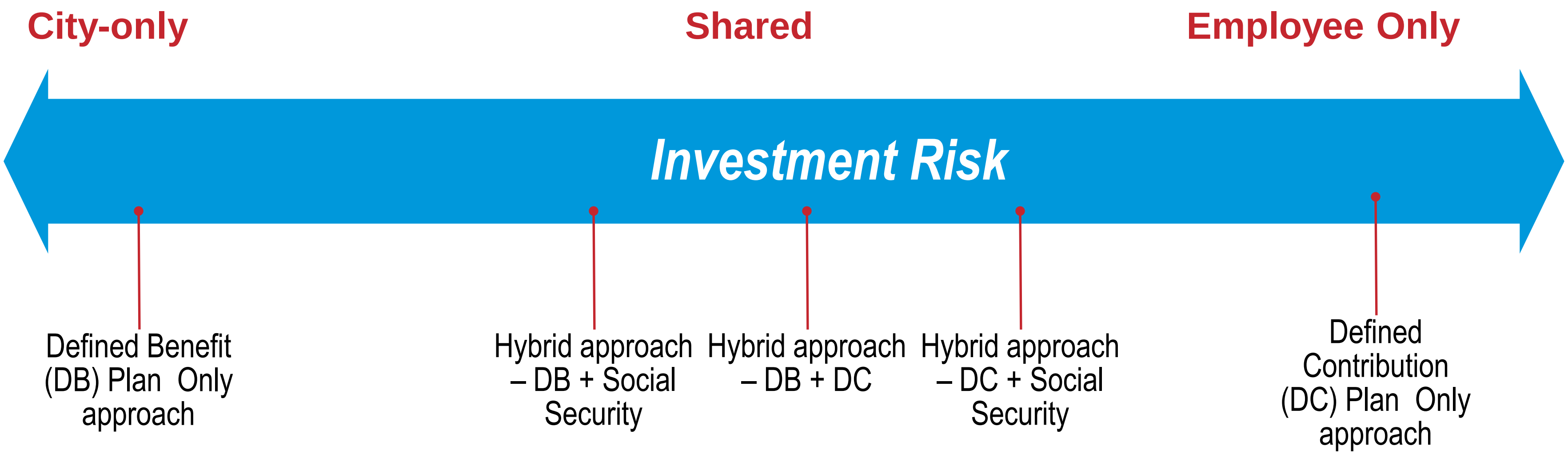
- Mayor's Option #1
- Hard Freeze and Shutdown Defined Benefit Plan
- Place all employees in Defined Contribution Plan that matches 125% of employee contributions up to 6%

3

Hybrid Plan Only approach

- Lower Defined Benefit Plan multiplier to 1.00% for all future service
- Cap retirement cost-of-living adjustment (COLA) at 1.00% for all future service
- Place all future employees in Social Security and Defined Contribution Plan that matches 100% of employee contributions up to 8%

Risk Profile of Options

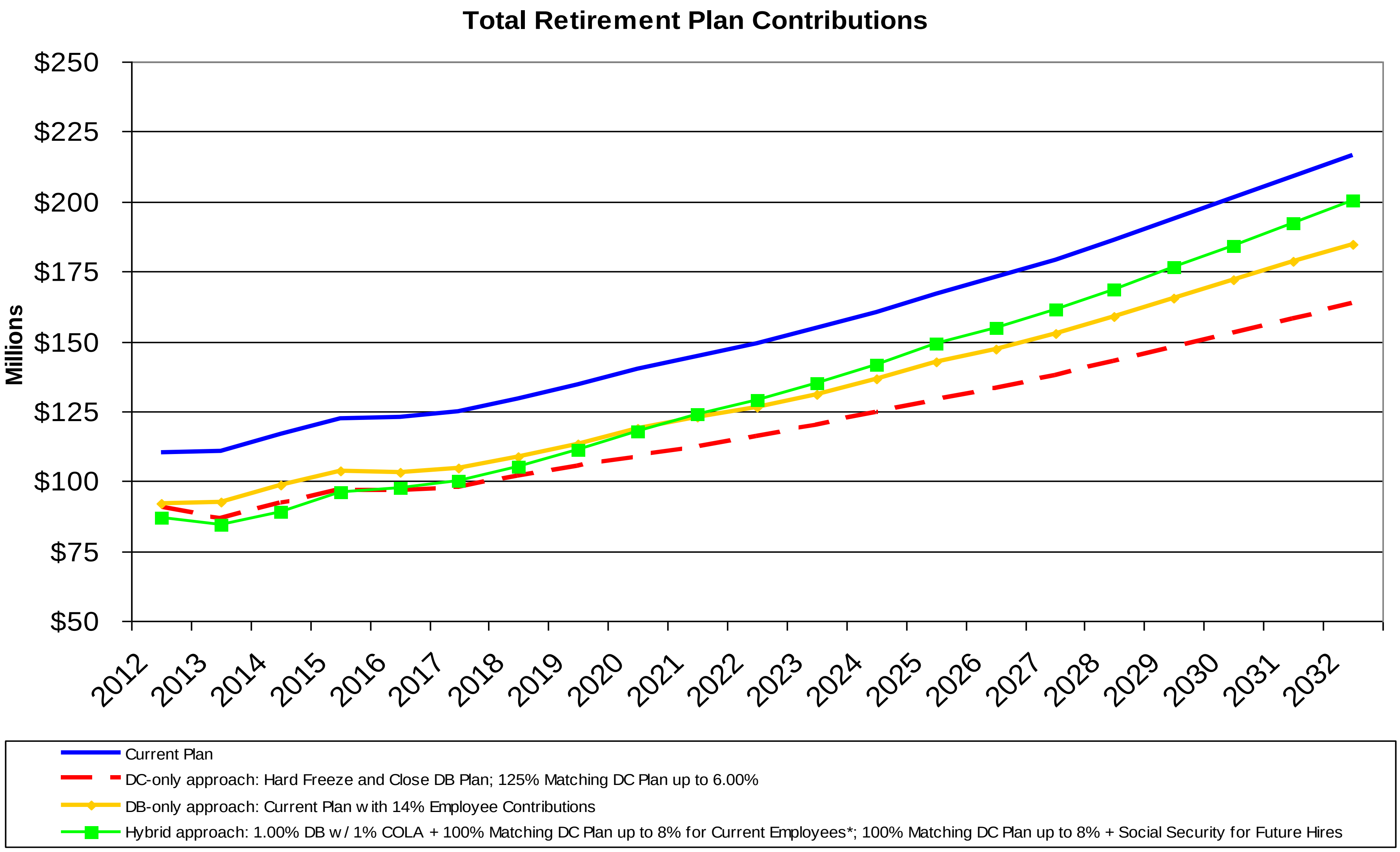


- **Under the Defined Benefit only approach the investment risk traditionally lies solely with the City**
  - However, there are techniques the City may use to share some of the investment risk with employees such as having variable employee contributions, capping the City's contribution at a certain percentage of payroll or dollar amount or altering the benefit formula.
- **The Hybrid approach allows for shared investment risk between the employee, City and/or Federal government.**
  - The Hybrid approach allows the City to reward those who save more for retirement while providing floors against poor investment returns
- **The employee shares all of the risk under a Defined Contribution (DC) only approach**
  - The DC only approach is funded annually and allows the City easy flexibility to increase contributions during good times or to assist employees during periods of poor investment returns.

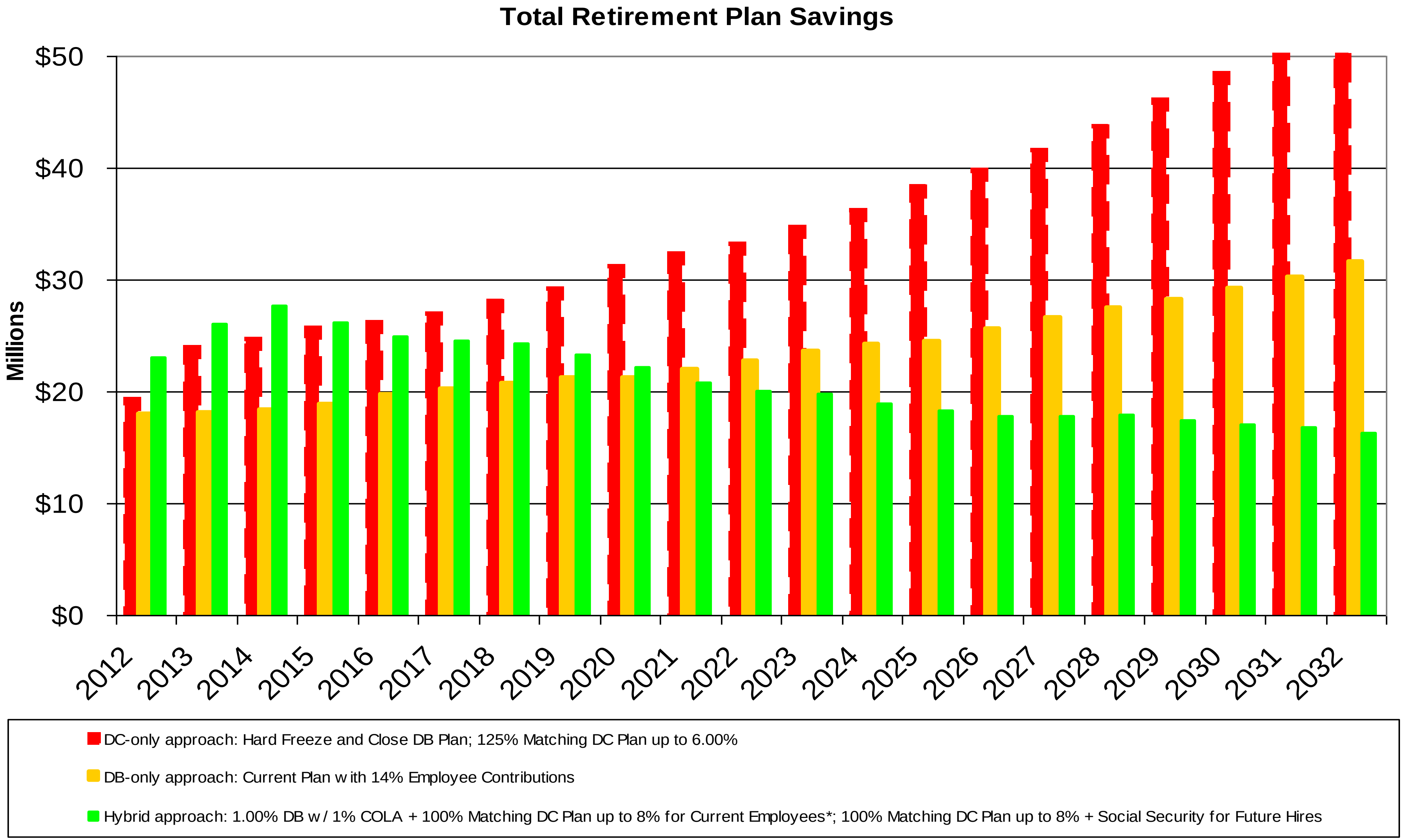
Projection Assumptions and Methodology

Discount Rate	8.00% for General; 7.75% for Police and Fire
Projected Investment Return	8.00%/7.75% annually unless specifically stated
Projection Methodology	Projected liabilities based on July 1, 2010 valuation assuming all Economic and Demographic assumptions are met thereafter; Future Hire age 35 (28 for Public Safety) with average salary of $35K ($40K for Public Safety) assumed to replace current employees such that participant counts remain constant; projected salary assumed to increase 3.00% per year
Market Value of Assets	Based on assets as of April 12, 2011 as reported by Gray & Co.; General Employees as of July 1, 2011 = $850,644,269 ; Fire as of July 1, 2011 = $414,976,000; Police as of July 1, 2011 = $611,645,000
Asset Valuation Method	5-year smoothing of investment gains/losses
Funding Method	Entry Age Normal (Segal replacement life methodology – i.e., Normal cost reflects current level of benefits)
Data	General Employees as of July 1, 2009 with age/service adjusted to July 1, 2010; Fire & Police as of January 1, 2010 with age/service adjusted to July 1, 2010
Employee's Contributions	Assumes employees contribute 11.00% toward retirement
City's Contribution	Based on July 1st valuation preceding fiscal year, adjusted for timing; Assumes City fully funds Annual Required Contribution (ARC); ARC = Normal Cost plus Payment to amortize Unfunded Actuarial Accrued Liability (UAAL) over closed 30-year period increasing approximately 3.50% per year

Impact on City:
8% Investment Return



Impact on City:
8% Investment Return



Based on assets as of April 2011 assuming 8.00% investment return and all assumptions met thereafter

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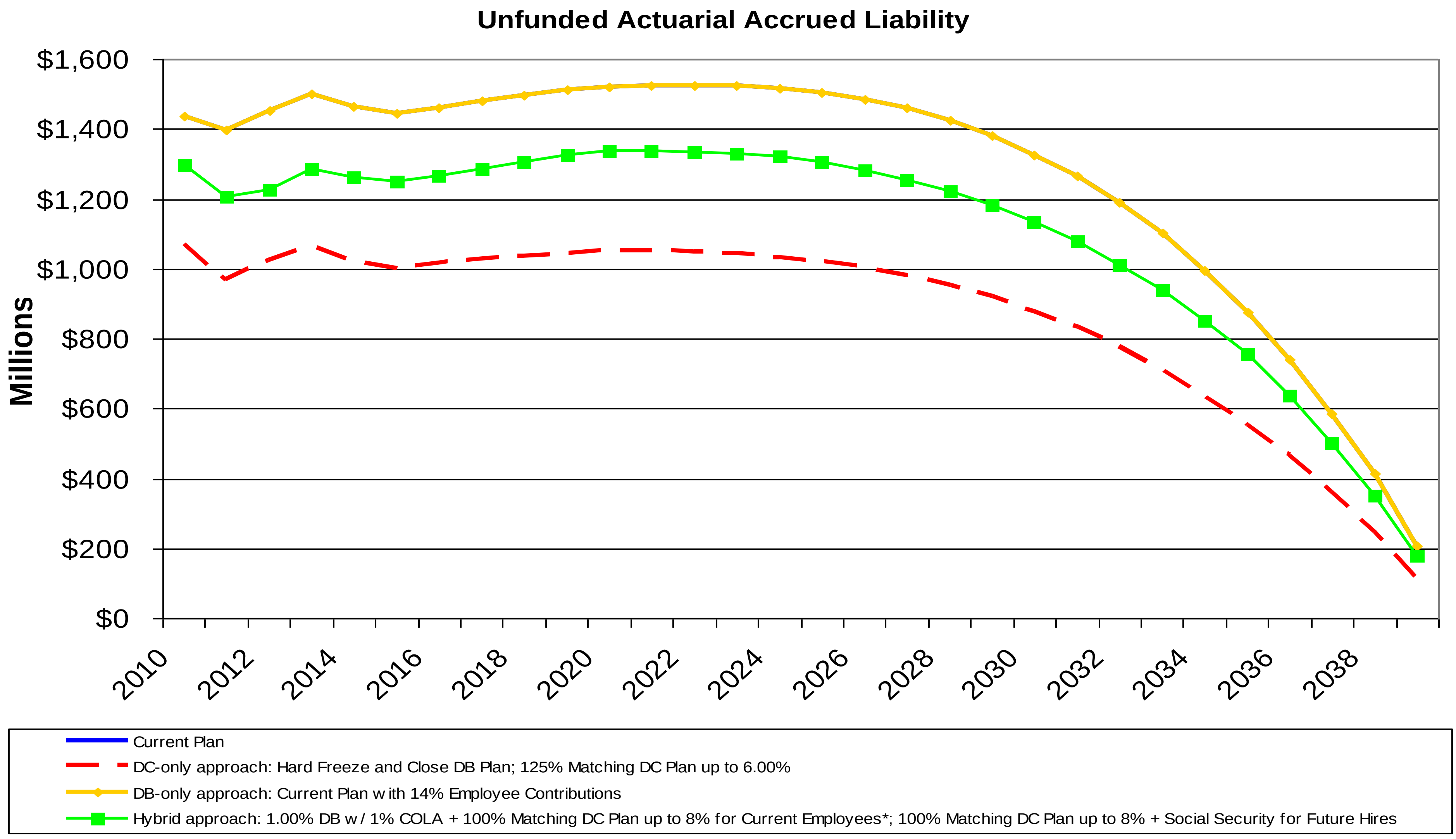
Impact on City:
8% Investment Return



Impact on City:
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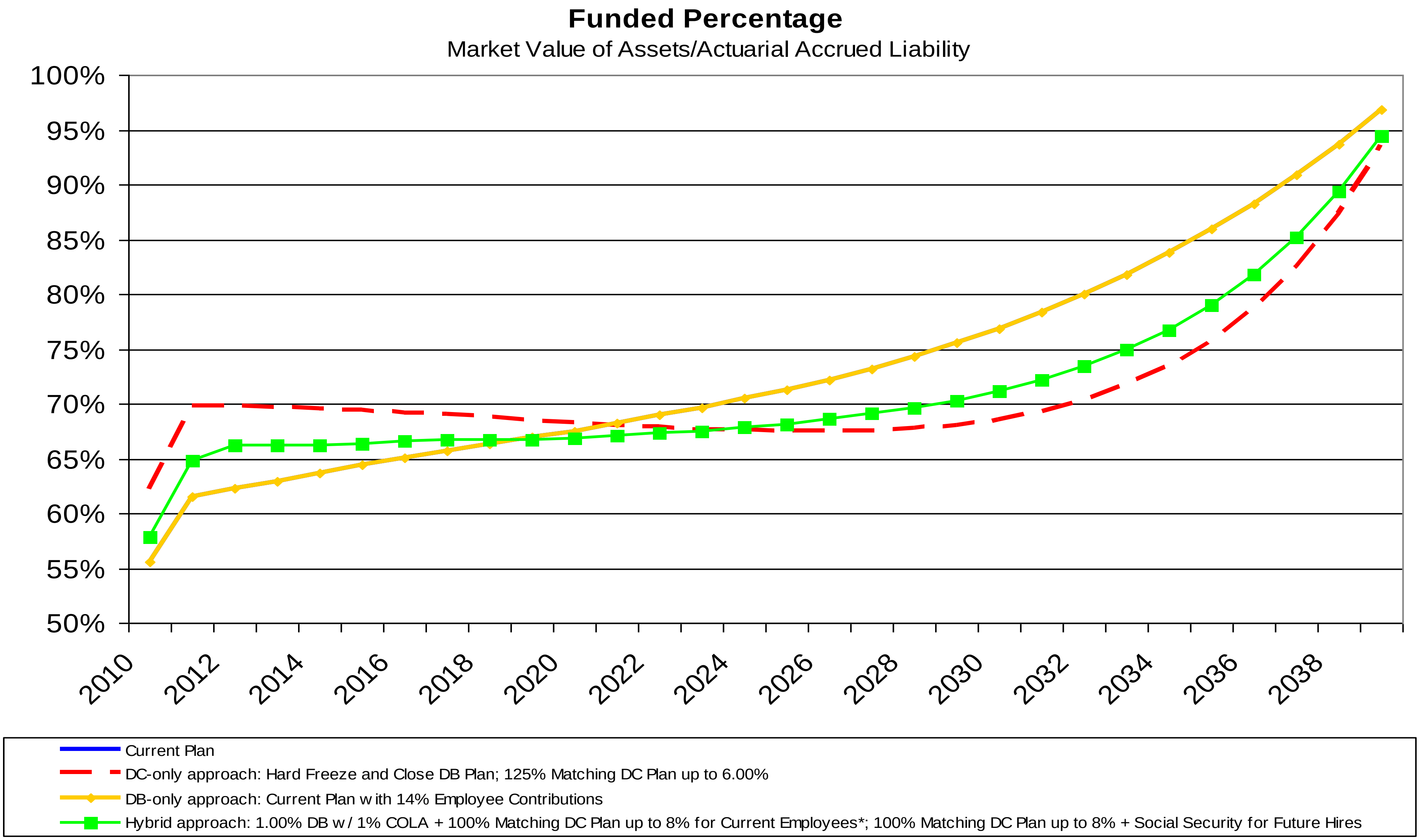

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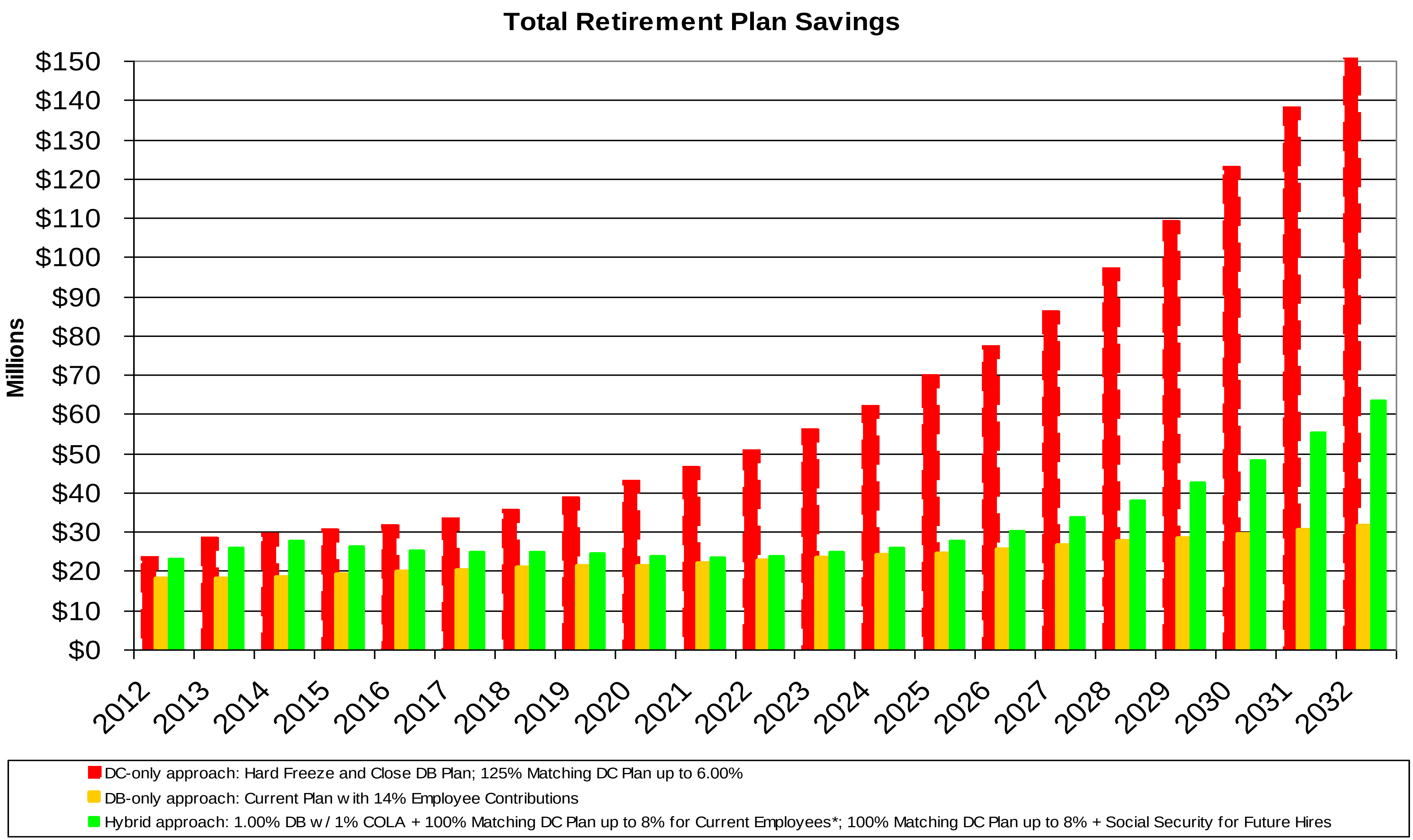
Impact on City:
3% Investment Return



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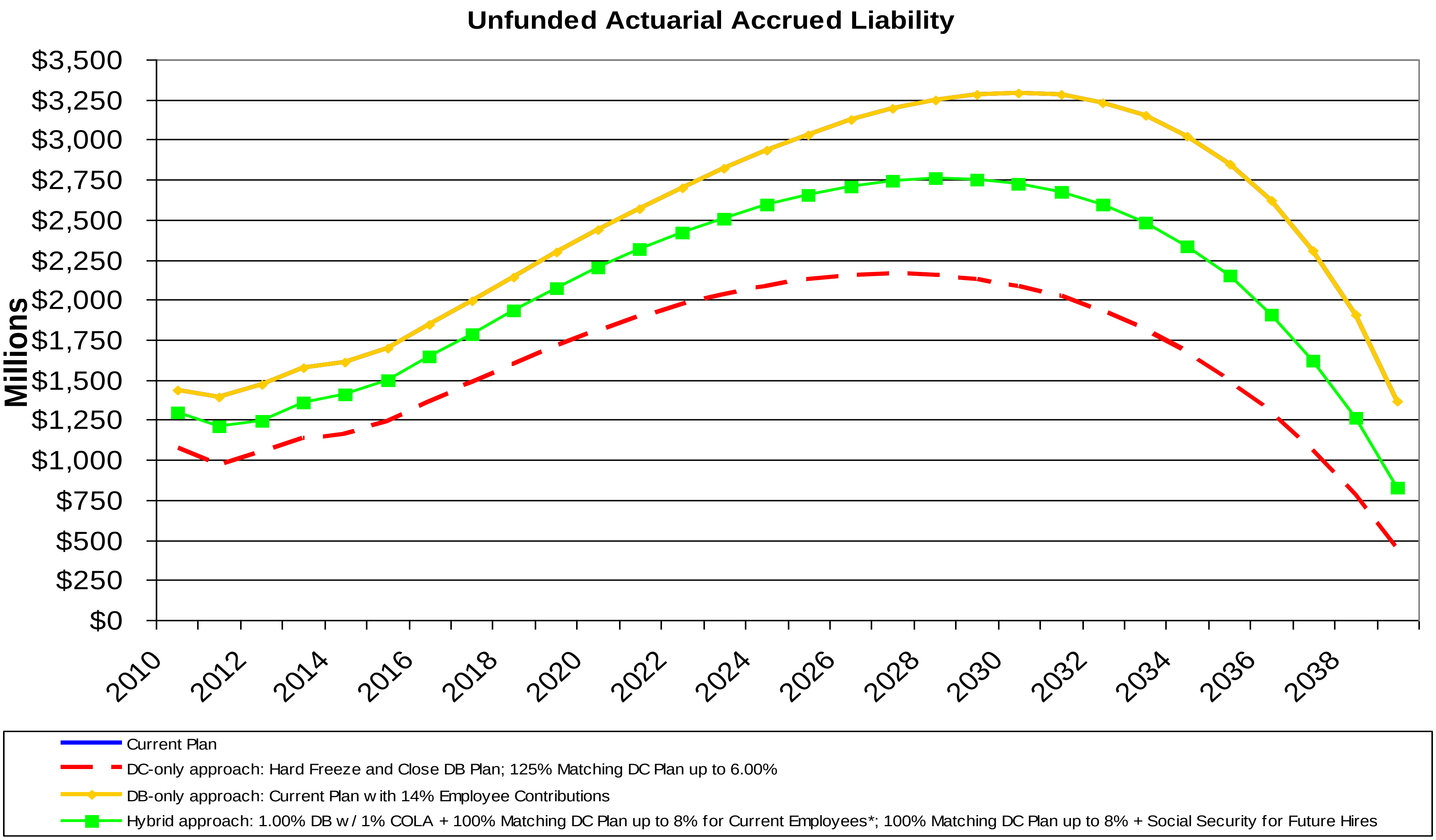
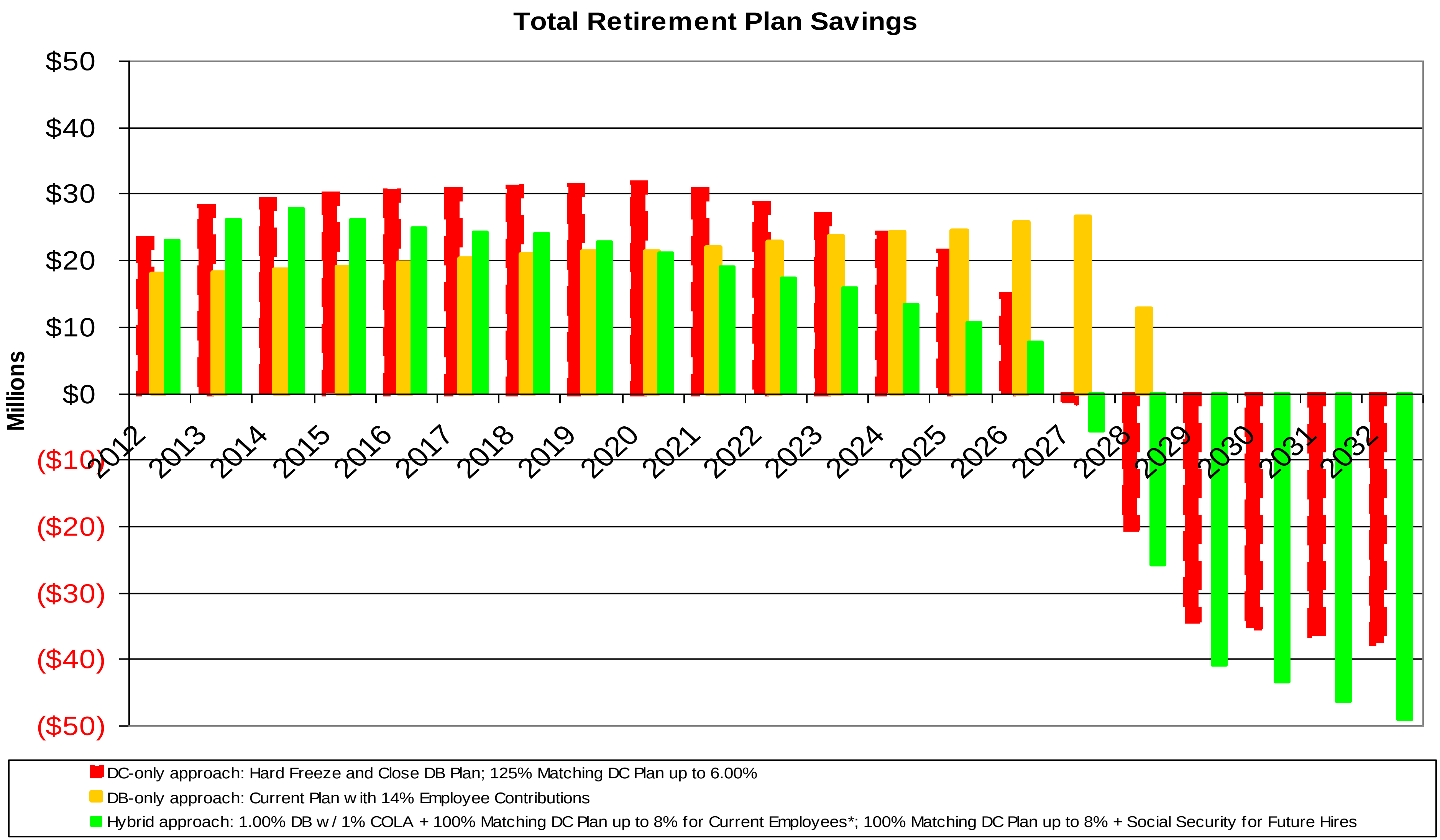
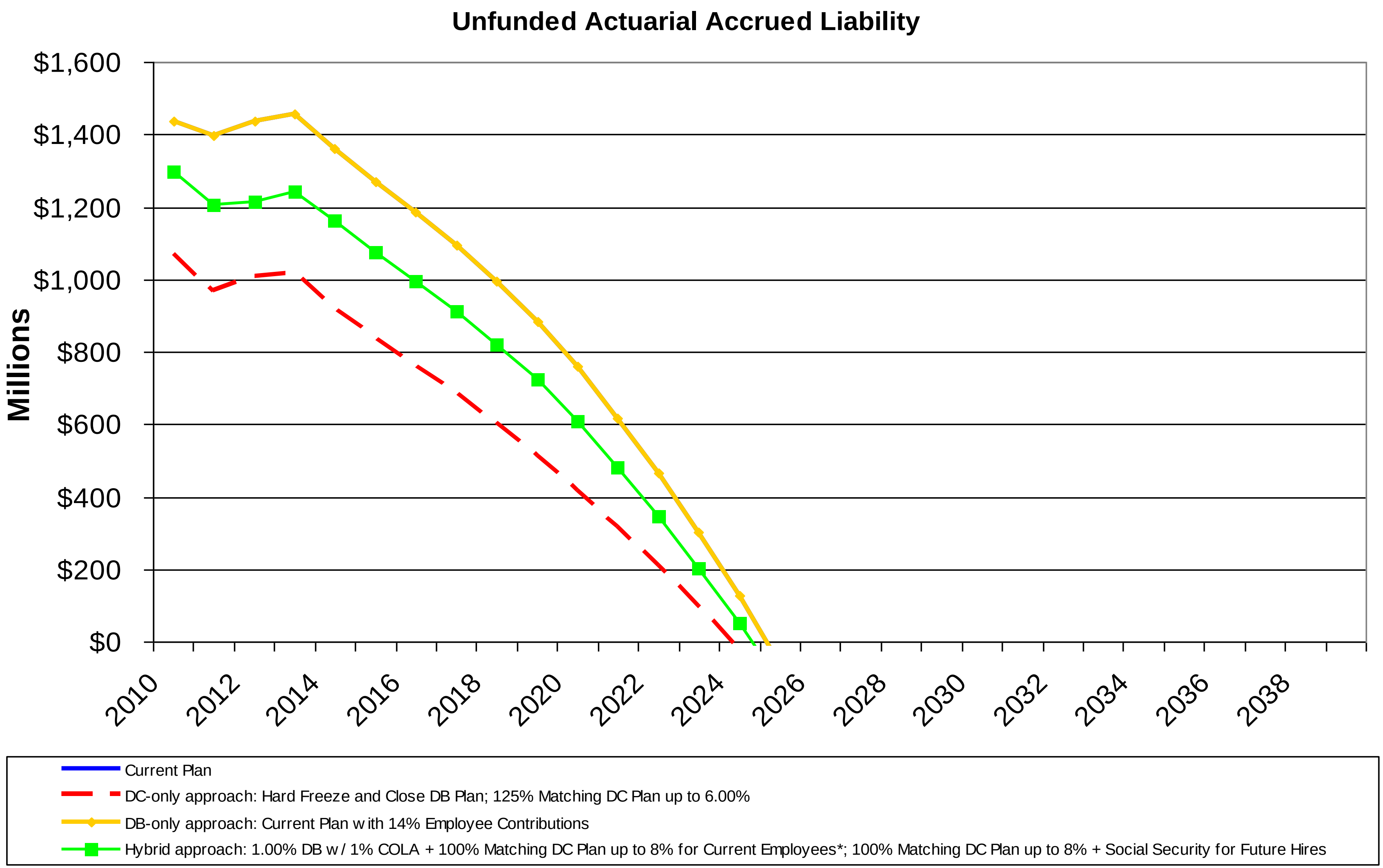


Impact on City:
11% Investment Return



Impact on City:
11% Investment Return



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1. Public Pension Environment and Trends
2. Options – Impact on City
3. **Options – Impact on Employees**
4. Plan Design Considerations
5. Appendices

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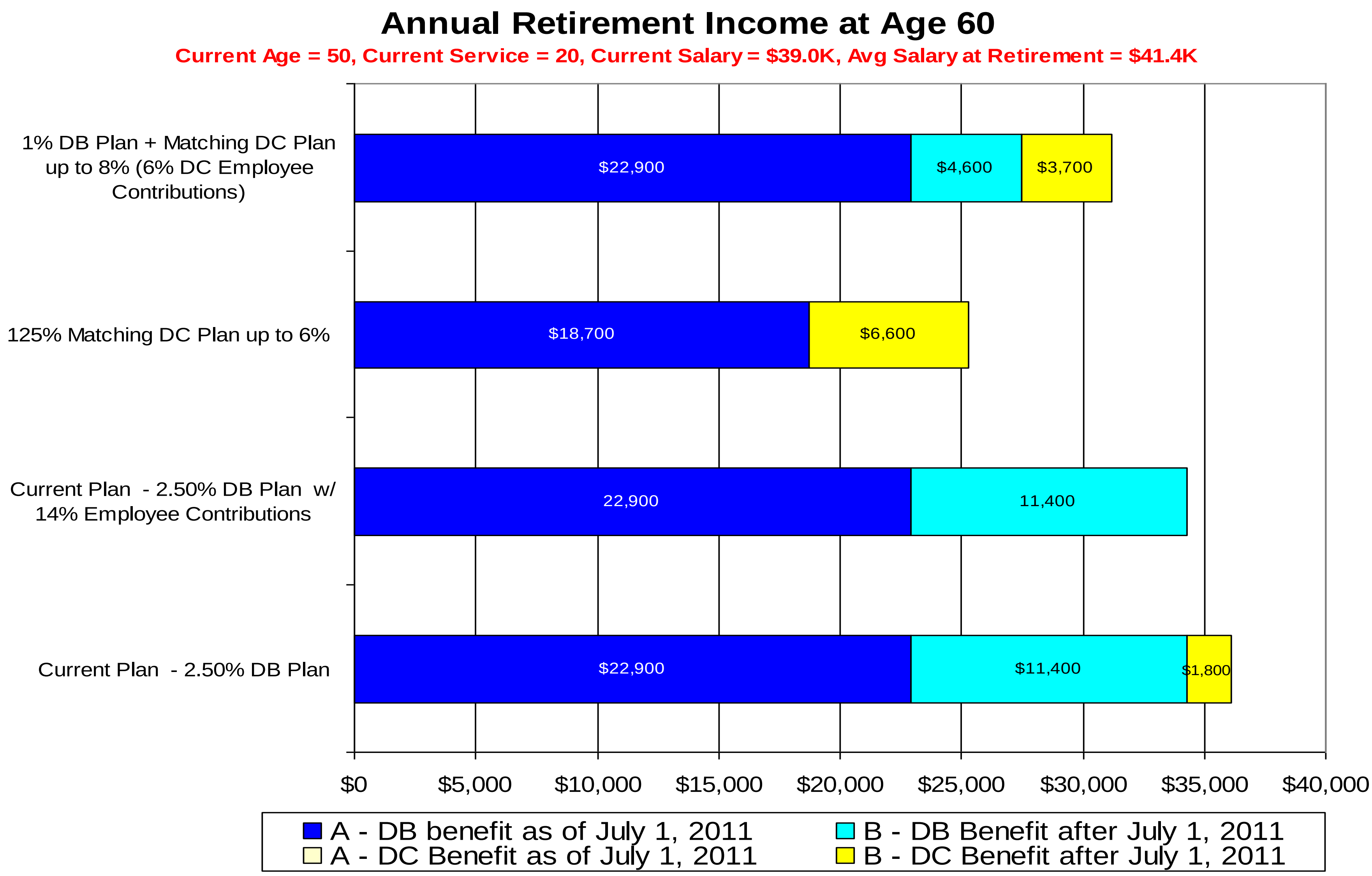
Employee Profiles Assumptions and Methodology

Salary growth	2.00% annual increase in salary;
Investment return	5.25% annual investment return on Defined Contribution (DC) and Savings Plans
Conversion of DC balances to annual annuities	Assumes employee balances in Defined Contribution and Savings plans converted to annuity at retirement based on RP-2000 mortality table (blended 50/50) at 1.94% rate;
Beginning DC and Savings balances	$0 personal Savings or DC account balances assumed as of effective date
Employee Contributions	Assumes 8.00% of salary contributions to DB plan (where applicable) unless specifically stated; 14.00% of salary total toward retirement;
Retirement Age	Age 55 for Public Safety; Age 60 for General Employees
Other	The samples do not make an adjustment for inflation in the 1.0% Hybrid Plan (the Current Plan and DC balances are assumed to keep pace with inflation)

Impact on Employees:
General Employee (20 Years of Service)



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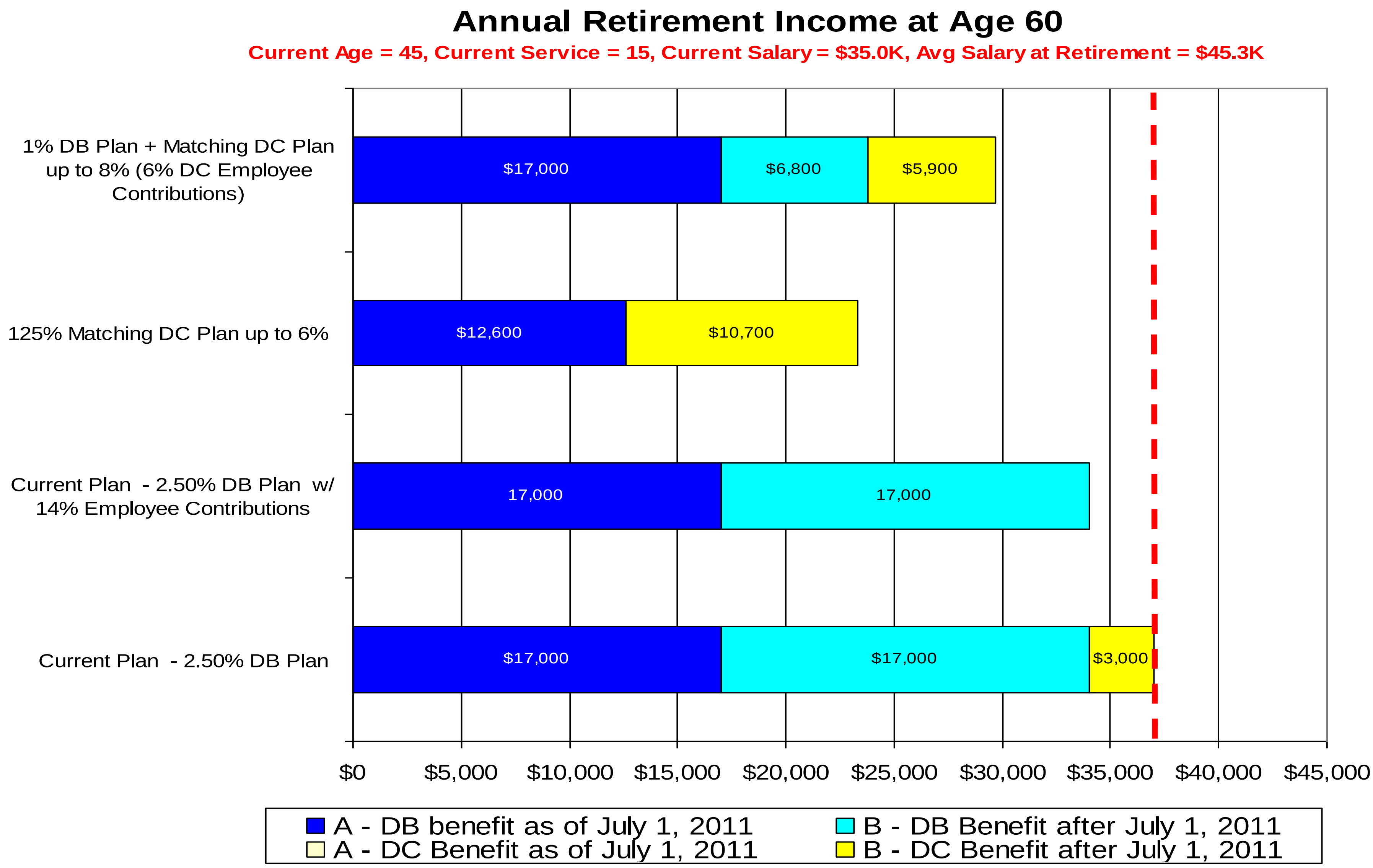
Impact on Employees:
General Employee (15 Years of Service)



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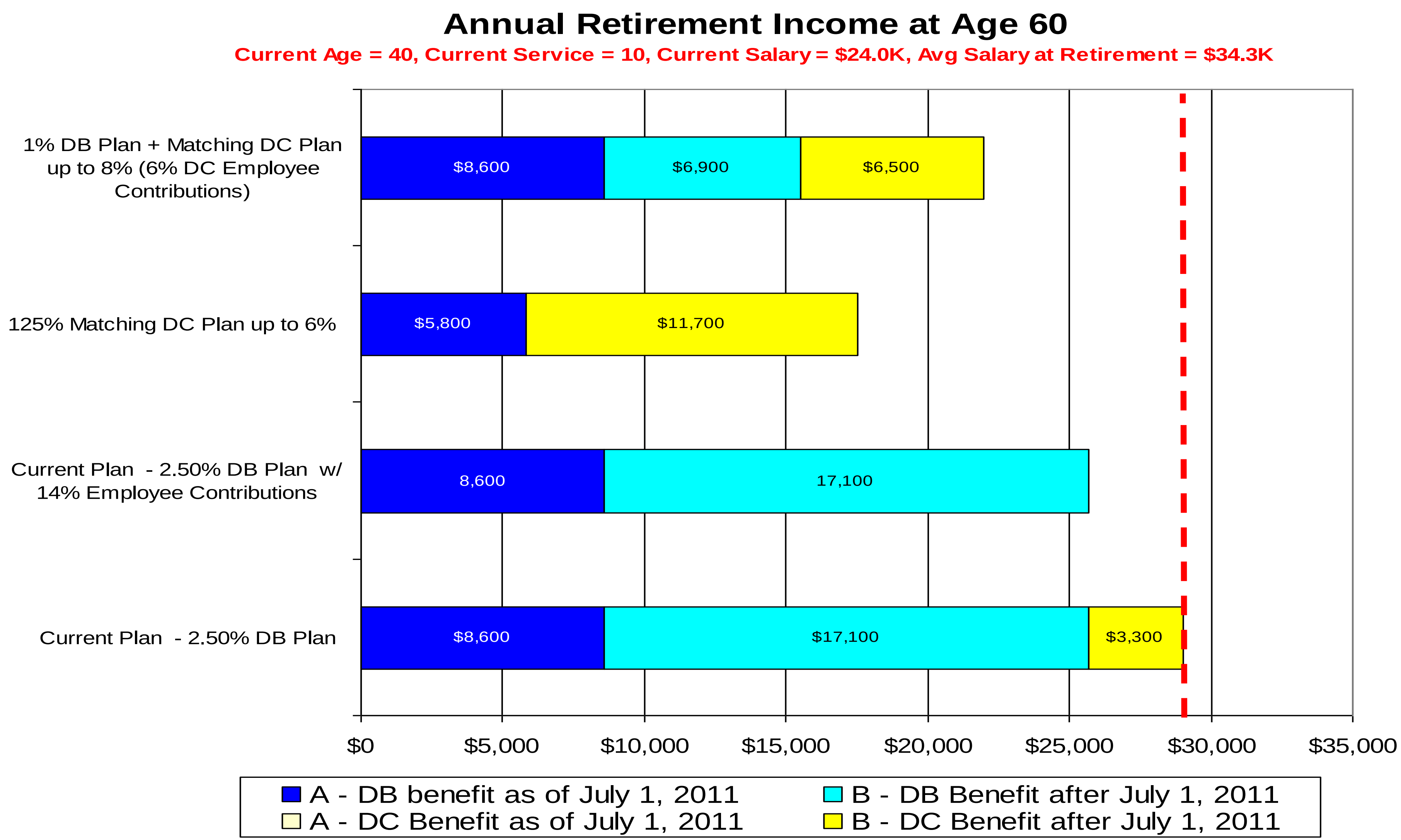
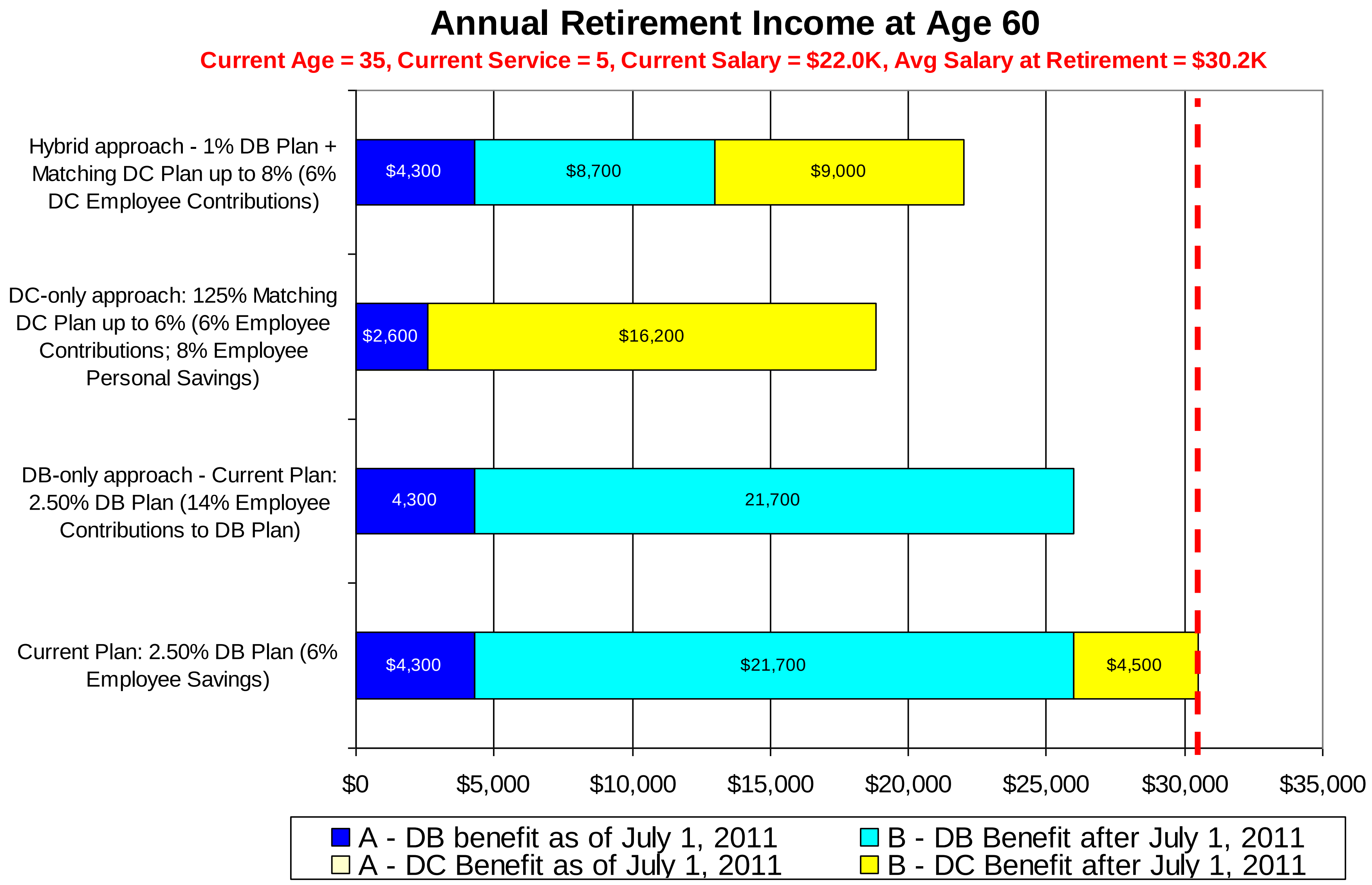
Impact on Employees:
General Employee (10 Years of Service)



Impact on Employees:
General Employee (5 Years of Service)



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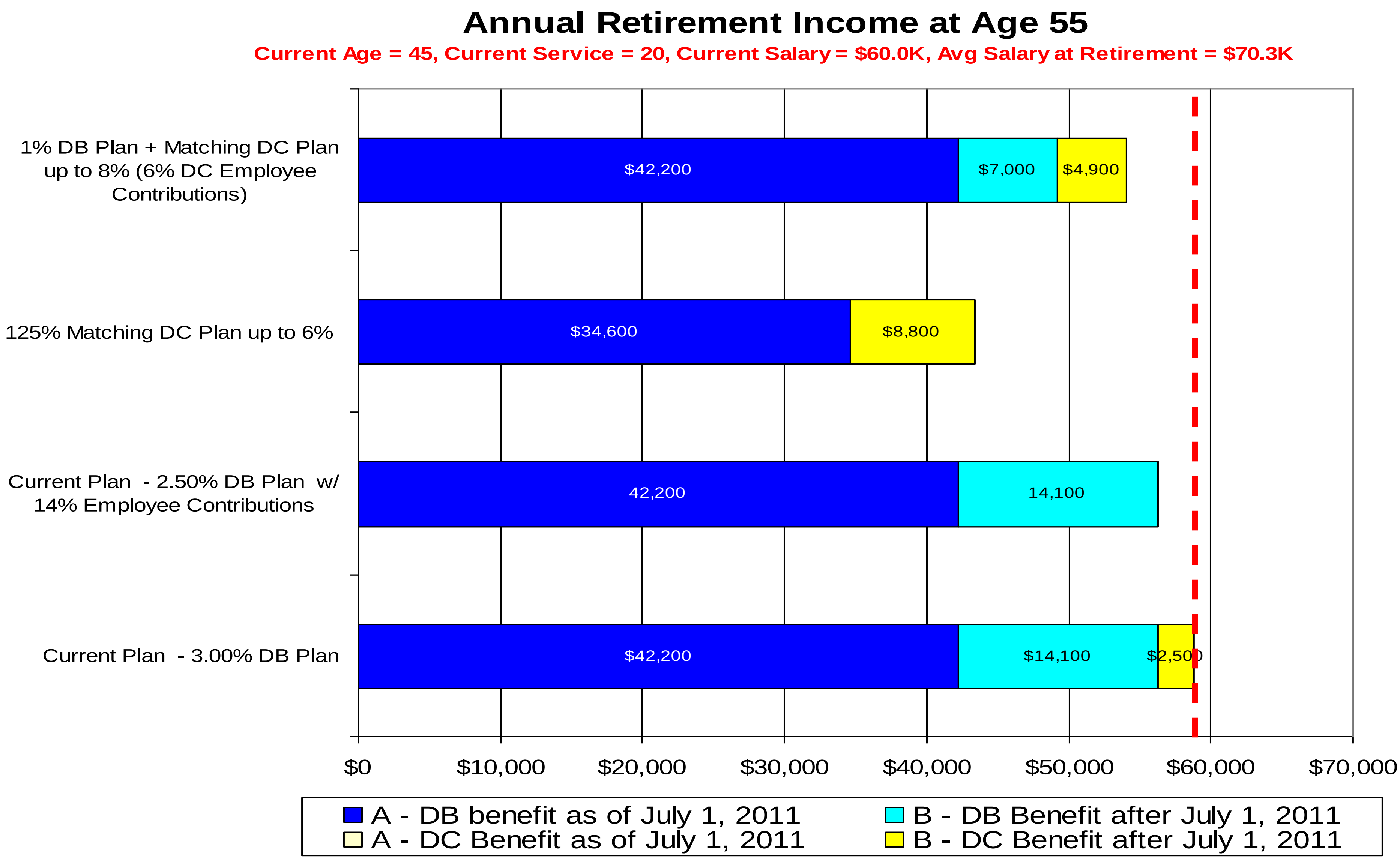
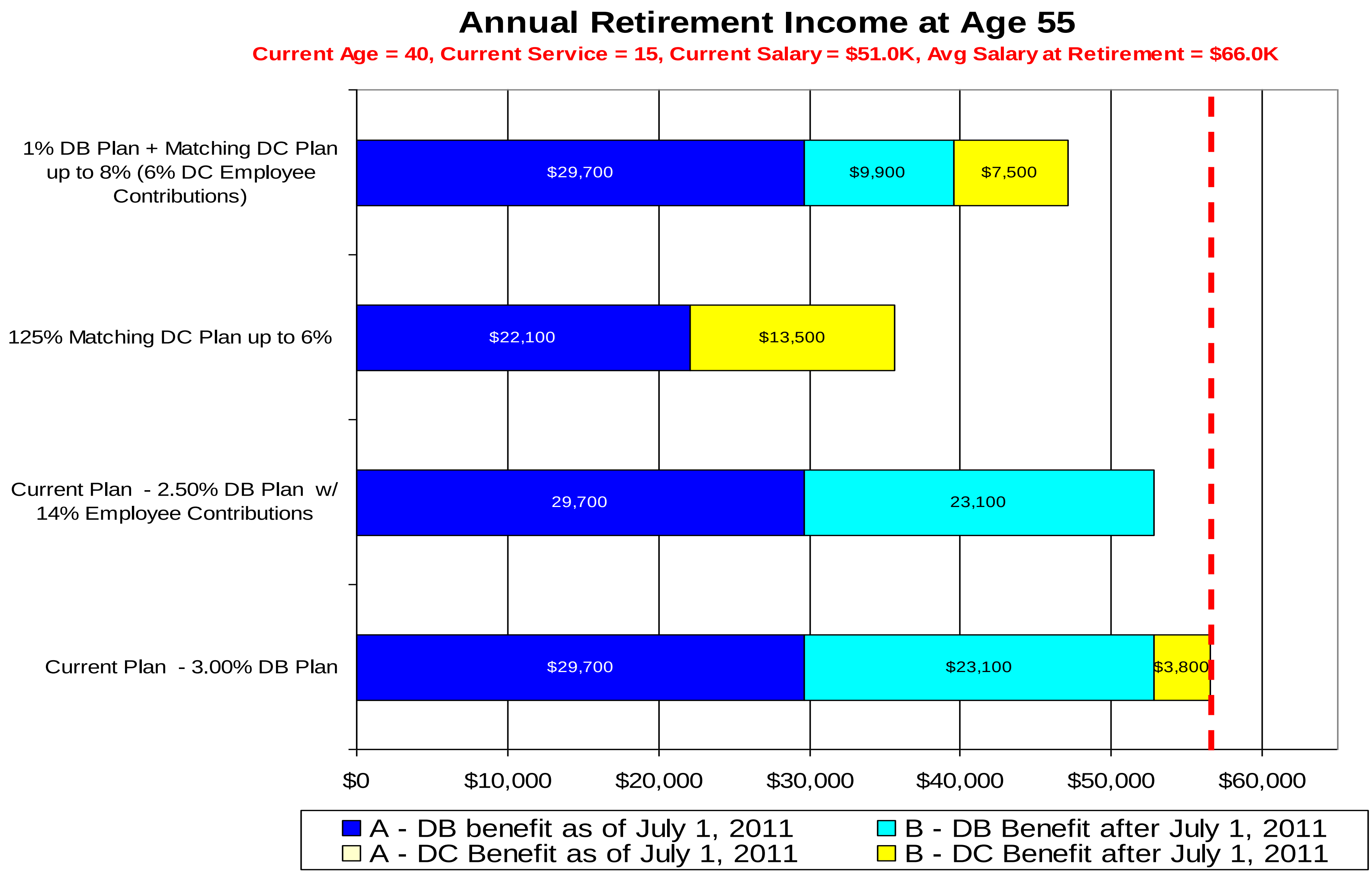
Impact on Employees:
Public Safety (20 Years of Service)



Impact on Employees:
Public Safety (15 Years of Service)



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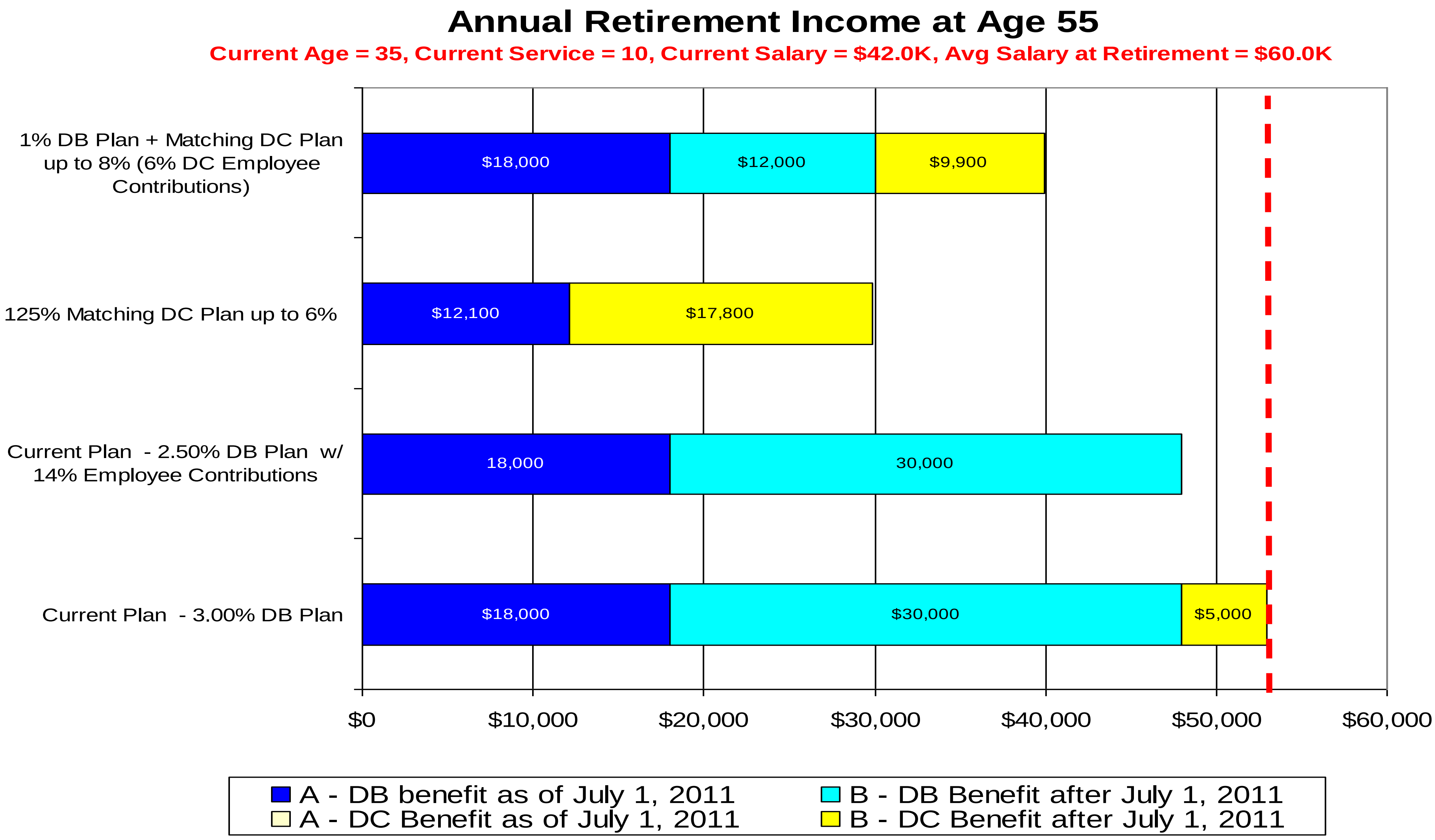
Impact on Employees:
Public Safety (10 Years of Service)



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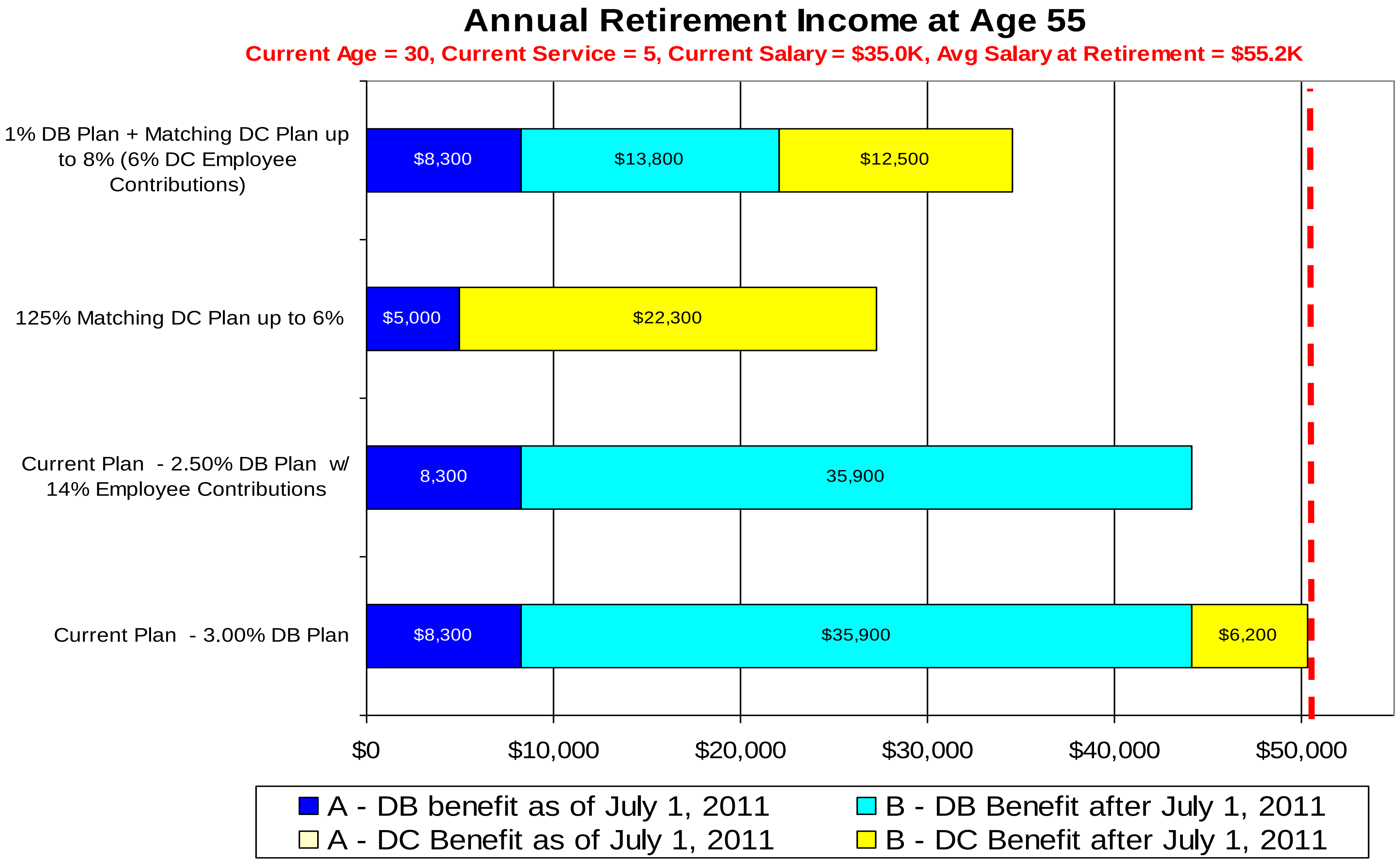
Impact on Employees:
Public Safety (5 Years of Service)



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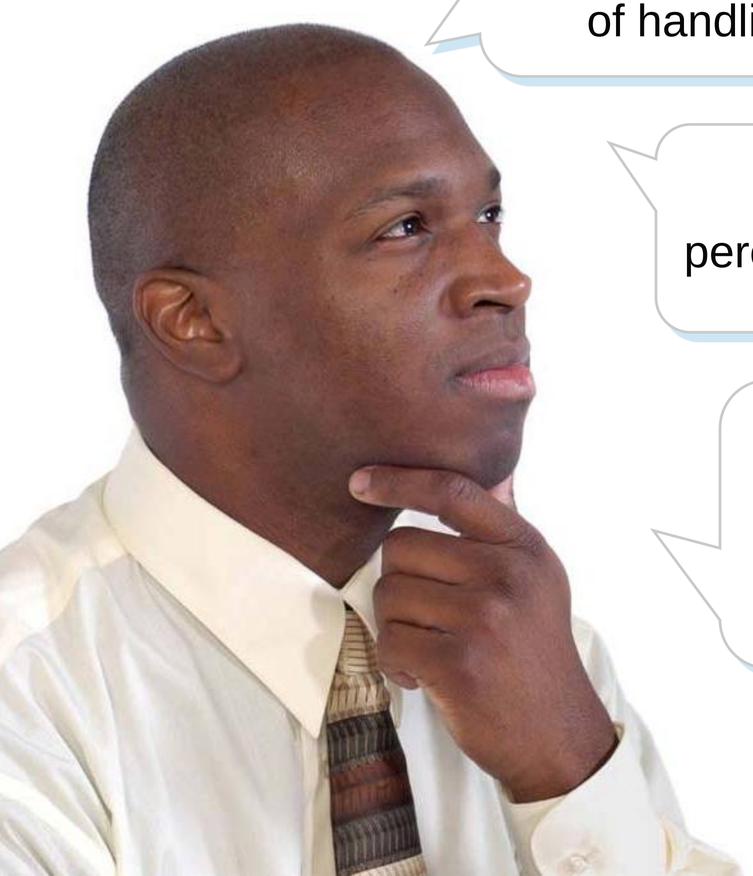
Additional Considerations

- Demographics
  - Aging population;
  - Educational level – employee training;
- Administrative complexity
  - Implementation;
  - Ongoing administration;
  - Staffing Levels and resources
- Competing concerns:
  - Employee;
  - Employer;
  - Taxpayer
- Healthcare issues: impact on retirement planning

Selecting the “Right” Plan



How do we mitigate financial risk?
Are employees capable of handling risk?

Who am I competing with for talent?
Will that change?
What are they doing?

How do I balance perceived and real value?

What are my future talent requirements? What type of retirement programs supports those needs?

Are benefits—and in particular retirement benefits—important in attracting and retaining employees?

Is adequacy of retirement income an issue?

Sample Decision “Matrix”

Decision Criteria	Options for Consideration		
	Option 1	Option 2	Option 3
Financial Criteria			
Predictable Cost: Is the contribution predictable based on known information such as participants’ annual compensation, expected annual employee contributions to DC plans, or percentage of general budget? ***Sample Goal: Predictable annual contribution***			
Funding Flexibility: Do funding requirements provide for varying contributions; (i.e., prefunding in good years and using the prefunding to help meet contribution requirement in other years?) ***Sample Goal: Flexibility to meet funding requirements***			
Reduce Unfunded Actuarial Accrued Liability (UAAL): Does the plan increase, decrease or have no effect on past service liability amounts? ***Sample Goal: Decrease unfunded actuarial accrued liability by $200 million***			
Benefit Security: Who/What/How are the retirement benefits promised to employees guaranteed to be paid? ***Sample Goal: To have a retirement program the City can afford over the long term and accumulate sufficient assets to pay all retirement benefits***			
HR Criteria			
Target Income Replacement Ratio: Will the new plan provide a benefit at normal retirement that meets the City’s Target Income Replacement Ratio? ***Sample Goal: Plan provides at least a 70% income replacement, from all sources***.			
Meaningful Benefit for Early Career Hires: Is the program designed to provide future early career hires adequate benefits at retirement? ***Sample Goal: To provide target income replacement ratio within City’s targeted range.***			
Meaningful Benefit for a Career Employee: Does the plan provide a future career employee a benefit at normal retirement that meets the City’s Target Income Replacement Ratio? ***Sample Goal: To provide target income replacement ratio within City’s targeted range.***			

Sample Decision "Matrix" *continued*

Decision Criteria	Options for Consideration		
	Option 1	Option 2	Option 3
HR Criteria (continued)			
Encourage Employee Savings: Will the retirement program provide a means and encourage individual employee savings for retirement? ***Sample Goal: To encourage employees to save for retirement***			
Employee Understanding/Appreciation: Will employees know what benefits to expect from the retirement program at retirement. How complicated are the plan benefits to explain and illustrate to participants? Are the plan provisions and eligibility requirements easy to follow? ***Sample Goal: For employees to know what benefits are promised and their value; To have a benefit plan that is easy to use and understand for the employee***			
Supports New Employee Recruiting: Are the benefits provided by the new retirement program the type (defined benefit, defined contribution or a combination) wanted by new employees? ***Sample Goal: To have the retirement program be a positive attraction for new employee recruitment***			
Positive Influence on Employee Retention: Are the benefits from all sources provided by the retirement program adequate for normal retirement (defined benefit, defined contribution, social security or a combination) wanted by employees? ***Sample Goal: To have a retirement program that provides adequate benefits at retirement and helps retain employees***			
Other			
Administrative Complexity: How complicated would the plan benefits be to calculate? Are the complications such that there is an increase on administrative cost? ***Sample Goal – to have a plan that the City can administer easily and maintains or lowers administrative cost***			
Predictability of Retirement Benefits: Will the benefits provided be determinable or is the benefit a function of the funds accumulated for the employee? ***Sample Goal: To have the retirement benefit definitely determinable***			
Risk of Litigation: Will the new plan limit exposure to litigation risk? ***Sample Goal: To develop a plan that meets current legal requirements and exposes the City to minimal litigation risk***			

Redesign Checklist

- ✓ Be knowledgeable of your entity’s fiscal condition
- ✓ Understand national financial, market, and economic environments and how they impact the pension system
- ✓ Determine pension principles
- ✓ Understand risk and design options
- ✓ Consider long term budget impact, costs, benefit levels, recruitment and retention

Have courage

Questions

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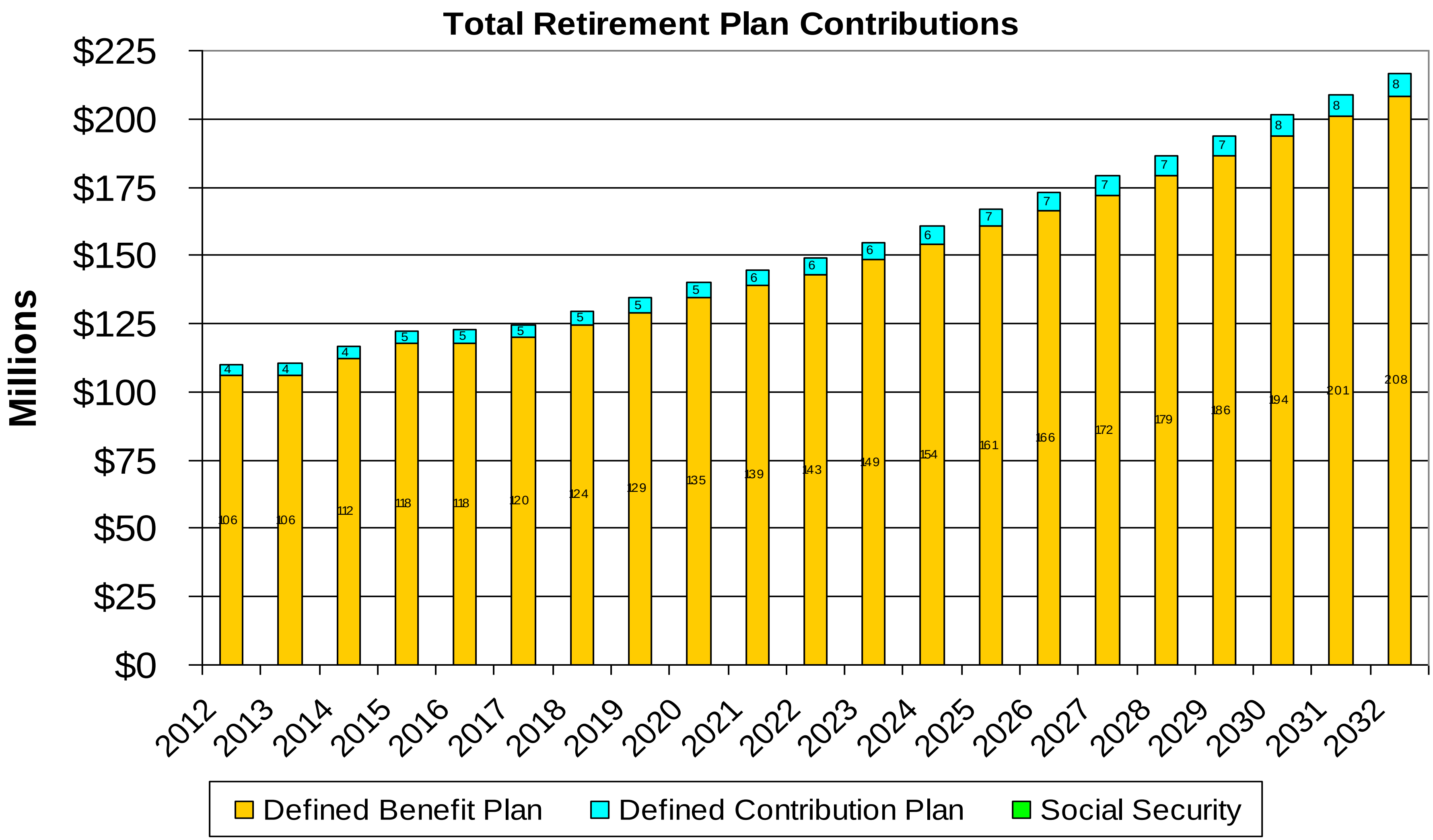
Breakdown of Retirement Plan Contributions: Current Plan



Based on assets as of April 2011 assuming 8.00% investment return and all assumptions met thereafter

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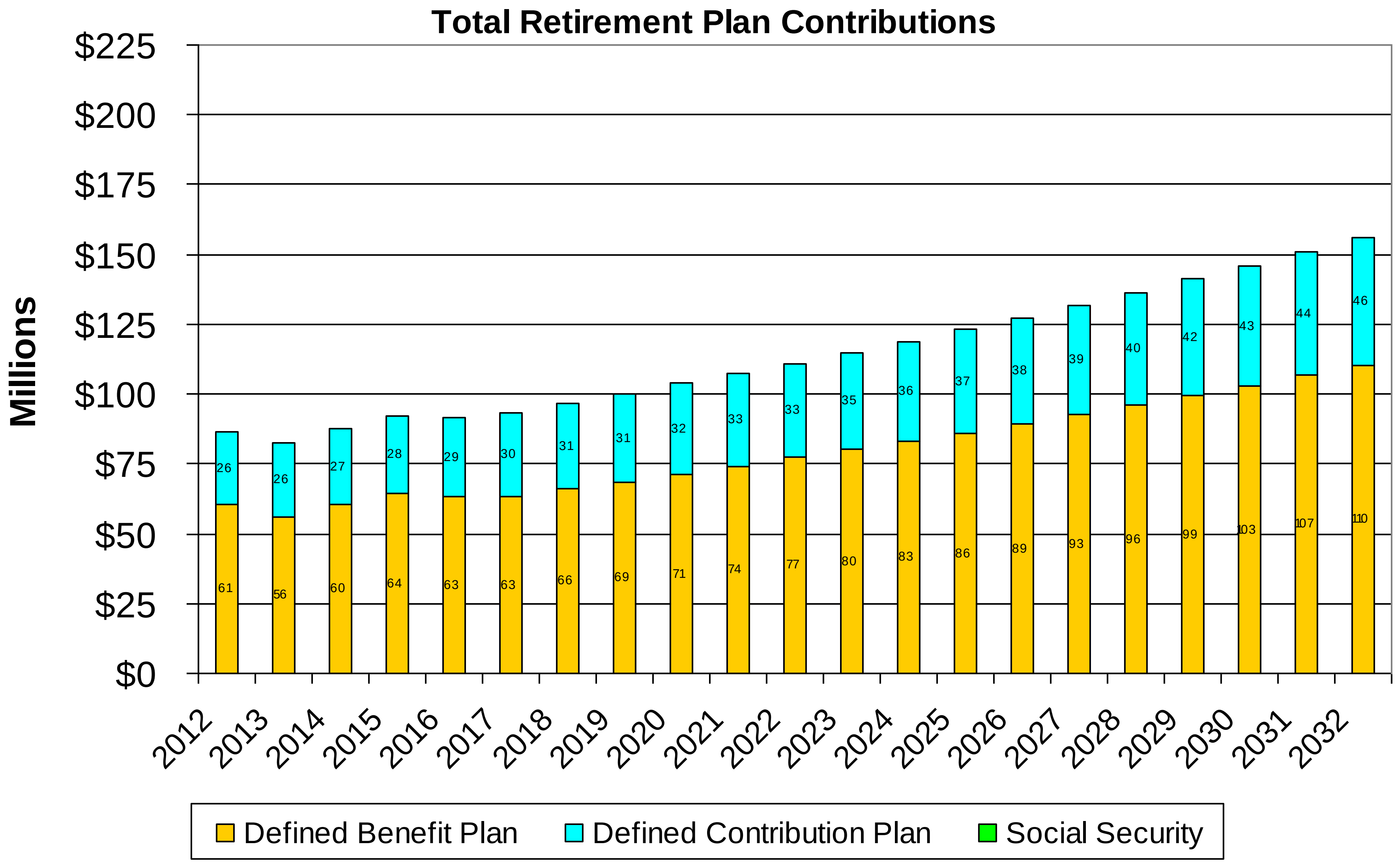
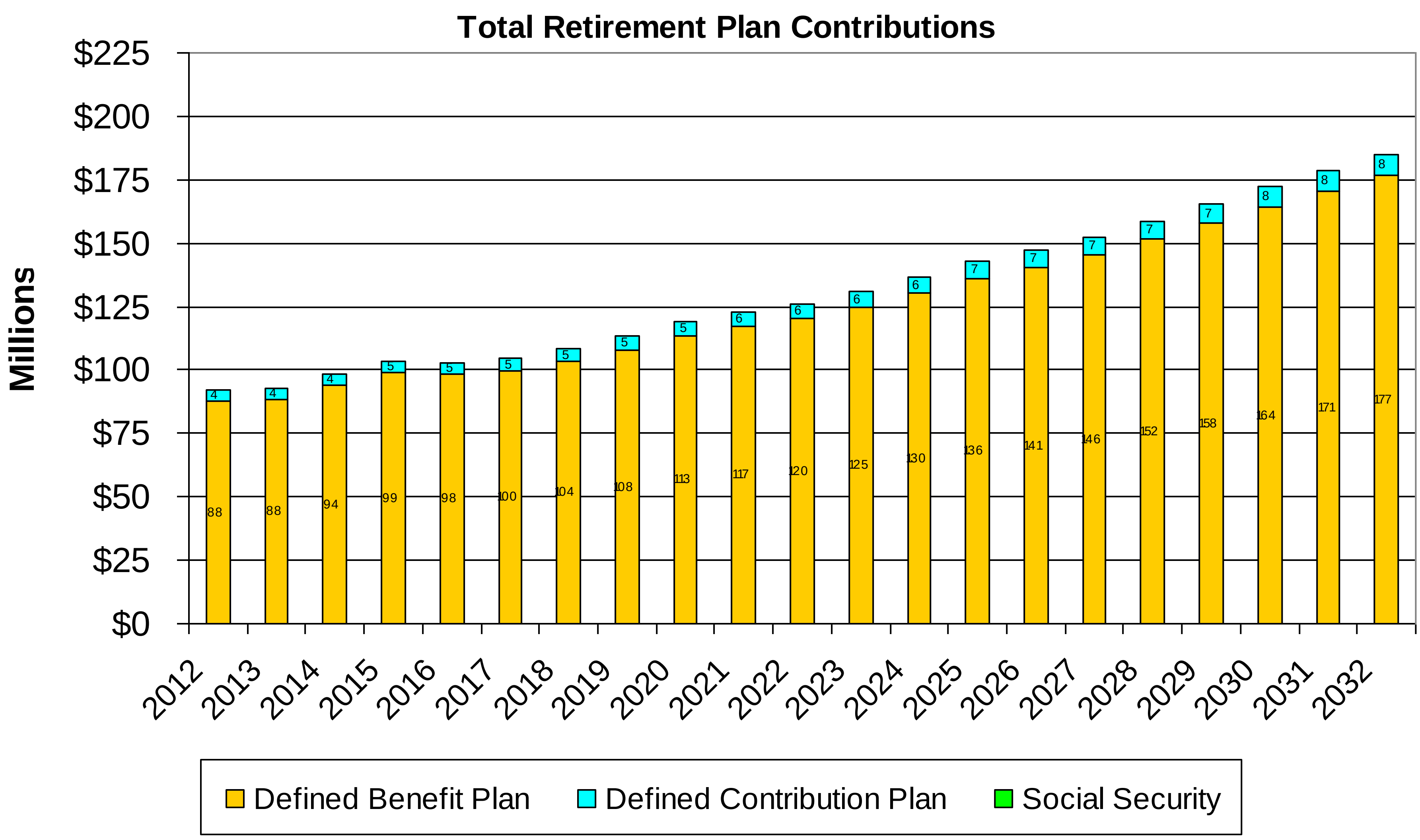
Breakdown of Retirement Plan Contributions:
DC-only approach (Hard Freeze DB; 125% Matching DC)



Based on assets as of April 2011 assuming 8.00% investment return and all assumptions met thereafter

Breakdown of Retirement Plan Contributions: DB-only approach (14% Employee Contributions)



Based on assets as of April 2011 assuming 8.00% investment return and all assumptions met thereafter

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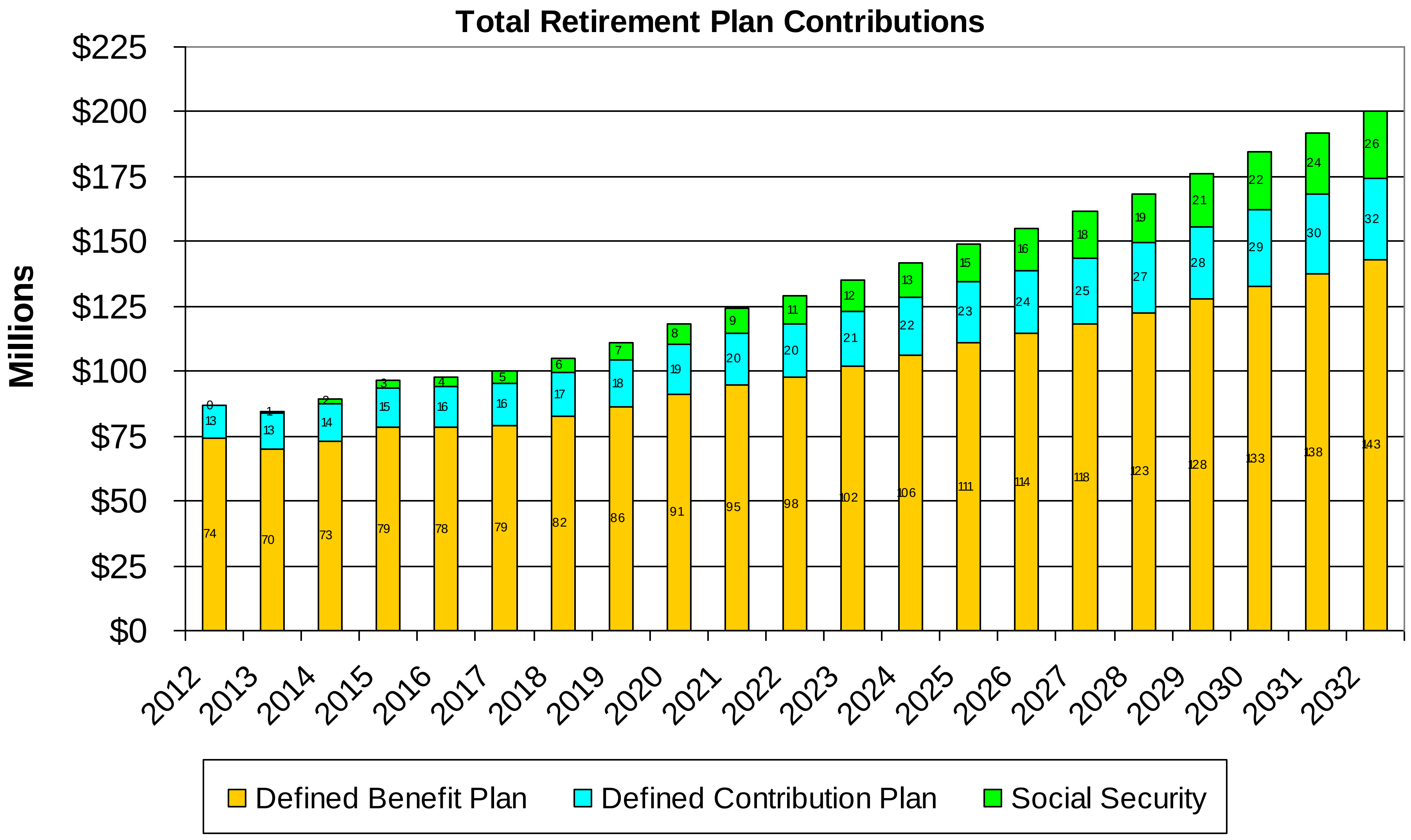
Breakdown of Retirement Plan Contributions:
Hybrid approach (1% DB Plan + Matching DC Plan up to 8%)



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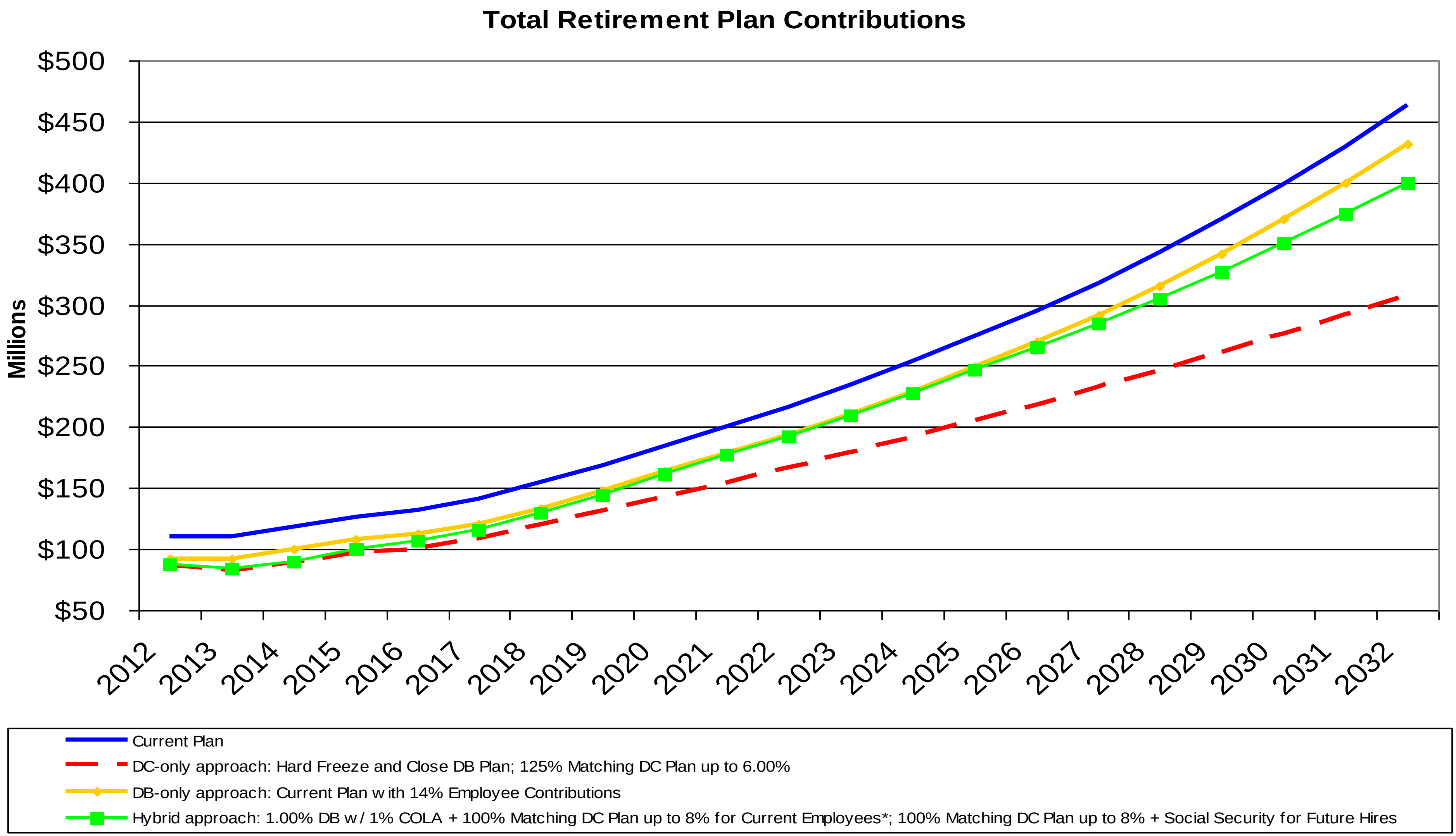
Impact on City:
3% Investment Return



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Impact on City:
11% Investment Return